BEFORE THE
PUBLIC SERVICE COMMISSION
OF MARYLAND

In The Matter Of The Review	*	
By The Commission Into	*	
Verizon-Maryland, Inc.'s	*	Case No. 8921
Compliance With The Conditions	*	
Of 47 U.S.C. §271(c).	*	

NON PROPRIETARY

BRIEF OF THE MARYLAND OFFICE OF PEOPLE'S COUNSEL

I. INTRODUCTION

Verizon-Maryland, Inc. (Verizon or Company) is seeking regulatory authority to enter into the long-distance market in Maryland. In order to gain that authority from the Federal Communications Commission (FCC), Verizon is required to comply with the dictates of 47 U.S.C. 271(c) which mandate that the Company meet certain market opening provisions of the Telecommunications Act of 1996. As part of the process of seeking authority to provide in-region interLATA long-distance service, all incumbent local exchange companies (ILECs) must provide information to state commissions of a sufficient nature to enable those commissions to draft consultative reports to the FCC regarding the ILECs' applications to provide in-region interLATA service in their respective states.[1]

As part of its long march down the eastern coast of the United States seeking this authority, Verizon has provided information to the Maryland Public Service Commission

[1] See 47 U.S.C. §271(d)(2)(B).

which purports to show that Verizon has met the market opening conditions of the Telecommunications Act. On April 12, 2002, Verizon made a partial Section 271 filing with the Maryland Public Service Commission (PSC or Commission). That first filing was an attempt to address the 14 point checklist set out in Section 271(c). On June 6, 2002, Verizon filed supplemental information consisting of information regarding Operation Support Systems (OSS) and its billing system. For ease of reference, the Commission has designated the consideration of the 14 point checklist Phase A and the analysis of OSS and billing as Phase B.

In adopting a procedural schedule, the Commission cautioned the parties that this proceeding is "not regulatory or adjudicatory and is nondecisional in character. This proceeding will not lead to a final order, decision, or enforceable Commission action."[2] The Notice of Procedural Schedule (and a subsequent Notice of Modification to Procedural Schedule) provided that parties could file testimony related to the Phase A Testimony and Declarations on July 15, 2002. The Commission allowed the Office of People's Counsel (OPC or People's Counsel) and its Staff to file Phase A Testimony and Declarations on July 29, 2002. The Commission also set out a Procedural Schedule regarding Phase B Testimony and Declarations.

The Office of People's Counsel filed the Testimony of Dr. Lee Selwyn on January 29, 2002. People's Counsel's Testimony in this proceeding focused solely on the public interest standard of Section 271 and requested Commission consideration of whether Verizon was meeting the separate affiliate requirements of 47 U.S.C. §272. People's Counsel's Testimony did not address any aspects of OSS and billing issues. Likewise, this Brief will be confined to a discussion of public interest and Section 272 issues.

II. ARGUMENT

A. The State Of Local Competition In Maryland--Especially For Residential Customers--Is So Dismal That Verizon's Application Must Be Rejected

1. Summary

If one thing can be said to be certain after listening to five days of testimony in this proceeding, it is that Verizon's Section 271 Application fails to show that local service is competitively available to all classes of consumers throughout all parts of the State of Maryland. On the other hand, it has been conclusively shown that Verizon's representations regarding the actual level of competition in the Maryland local service market are extraordinarily inflated because they are based on Verizon's flawed analysis of the E911 data base and a flawed measurement of the number of completed collocation arrangements. These flaws in Verizon's analysis could lead to the mistaken impression that there is vigorous CLEC penetration in all areas of Maryland and for all types of services. Furthermore, the analysis by Verizon fails to take into account that opportunities for further CLEC competition have been substantially constricted due to a number of CLEC bankruptcies and a less than ideal economic situation.

People's Counsel recognizes that the Commission may feel that it cannot stand in the way of the advancing avalanche of approved Section 271 applications throughout the Verizon service territory. However, People's Counsel believes that this proceeding provides an ideal set of facts for the Maryland Commission to hold up the big STOP sign. The Commission should avail itself of the opportunity to say to Verizon that it has failed to meet the intent of the Telecommunications Act of 1996 that local service competitive options be available to all consumers throughout all parts of the State.

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[2] Notice of Procedural Schedule, Case No. 8921, p. 2-3 (June 11, 2002).

As an alternative to outright rejection of Verizon's 271 application, People's Counsel urges the Commission to consider whether it should order that the Application should be approved only for business services as distinguished from residential services. This would acknowledge that competition for residential services has utterly failed to materialize in the Verizon/Maryland territory.

2. <u>Requirements Of The Telecommunications Act</u>

Although People's Counsel does not intend in this Brief to go into the requirements of the Telecommunications Act of 1996 at length because the Commission has been very well acquainted with the provisions of the Act, it is important to refresh the Commission's recollection of the requirements contained in Section 271 of the Act. Section 271(d)(2)(B) of the Act requires the FCC to consult with the state commission for the state in which Section 271 approval is sought to verify the incumbent's compliance with the requirements of Section 271(c). Section 271(c) requires the incumbent to show that it has one or more state-approved interconnection agreements with a facilities-based competitor providing telephone exchange service, or a Statement of Generally Available Terms (SGAT) and that either the interconnection agreements or the SGAT satisfies the 14 point "competitive checklist" set forth in Section 271(c)(2)(B)(i)-(xiv).[3]

The Act also imposes other duties upon the incumbent. For example, the incumbent must show that the authority to provide long-distance service it is requesting will be carried out in accordance with the requirements of Section 272 of the Act

[3] See Selwyn Direct Testimony, p. 11, Table 1 for the checklist items and the cross-reference to the Act for those items.

regarding the provision of long-distance service through a separate affiliate or affiliates.[4] Finally, the incumbent must show that its entry into the in-region interLATA market is "consistent with the public interest, convenience, and necessity" under Section 271(d)(3)(C).

The FCC has also acknowledged that apart "from determining whether a BOC satisfies the competitive checklist and will comply with Section 272, Congress directed the FCC to assess whether the requested authorization would be consistent with the public interest, convenience, and necessity." *See Application of Verizon New England, Inc., Bell Atlantic Communications, Inc., NYNEX Long Distance Company and Verizon Global Network's Inc., for authorization to provide in-region interLATA services in Massachusetts*, FCC 01-130, CC Docket No. 01-9, para. 232 (April 16, 2001). The FCC views the public interest requirement as an opportunity to review the circumstances presented by the applications "to ensure that no other relevant factors exist that would frustrate the Congressional intent that markets be open, as required by the competitive checklist, and that entry will therefore serve the public interest as Congress expected. Among other things, we may review the local and long distance markets to ensure that there are not unusual circumstances that would make entry contrary to the public interest under the particular circumstances of the application at issue. Another factor that could be relevant to the analysis is whether the Commission has sufficient assurance that markets will remain open after grant of the application. While no one factor is dispositive in this analysis, the overriding goal is to ensure that nothing undermines the conclusion, based on the Commission's analysis of checklist compliance, that markets are open to competition." *See Re Application of Verizon Virginia, Inc., et al. for*

[4] For a more in-depth discussion of this Section of the Act, please see Section H *supra.*

Authorization To Provide In-Region, InterLATA Services In Virginia, FCC 02-297 (WC Docket No. 02-214), p. (October 30, 2002)

As Dr. Selwyn has testified, the public interest requirement of the Act should be interpreted very broadly to include an analysis of the impact on competition in both the Maryland local and long-distance markets.[5]

As will be more fully explained *supra*, although Verizon currently has a few localized competitors, if it is authorized to offer in-region interLATA service while still maintaining what is effectively a monopoly in the local market, giving it the requested authorization would clearly not be "consistent with the public interest, convenience and necessity" as required by the Act. There is sufficient evidence in this proceeding to show that the level of local competition is significantly overstated. Given the evidence, People's Counsel believes that this Commission would be well within its rights if it rejected Verizon's application. As an alternative, People's Counsel believes that this Commission could grant Verizon's application in part as it relates to business service and reject it as it relates to residential service. Finally, People's Counsel believes that the Commission could also, along the lines of the California Public Utilities Commission, grant Verizon's application but impose certain conditions to ensure that Verizon does not abuse its monopoly position to any great extent.[6]

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[5] See Selwyn Direct, p. 10.

[6] The California Public Utilities Commission voiced its misgivings about granting Pacific Bell's § 271 Application. The Commission stated:

> While Pacific largely satisfies the technical requirements of § 271…, we cannot state unequivocally that we find Pacific's imminent entry into the long-distance market in California will primarily enhance the public interest. Local telephone competition exists in the technical and quantitative data; but it has yet to find its way into the residences of the majority of California's ratepayers. Only time and regulatory vigilance will determine if it ever arrives. We expect that the public interest will be positively served in California by the addition of another experienced,

B. V erizon Has Failed To Establish That There Are Competitive Choices Available To All Consumers In All Parts of Maryland

It is clear from the Testimony that to the extent there is any local competition in Maryland, it is exceedingly small in percentage terms. In fact, Verizon's application provides "scant evidence that there is any facilities-based competitive entry outside of a few core urban-wire centers in Maryland."[7]

Dr. Selwyn provided an extensive critique of the information provided by Verizon regarding the extent of competition geographically in Maryland.[8] Dr. Selwyn pointed out that more than half of Verizon's central offices have no CLEC collocation arrangements and that given the current crisis in the telecommunications industry, it appears that facilities based expansion to the unserved central offices will not occur any time soon. As Dr. Selwyn testified, "absent evidence that each and every geographic area in Maryland is sufficiently open to competition, approval of this Application runs the risk of ignoring the vital interests of those Maryland ratepayers who have no choice but to take their local exchange service only from Verizon."[9]

Throughout the proceeding, there has been much disagreement among the parties on the best way to measure CLEC market penetration. In People's Counsel's view, the

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> formidable competitor in the intrastate interexchange market. At the same time, we foresee the harm to the public interest if actual competition in California maintains its current anemic pace, and Pacific gains intrastate long-distance dominance to match its local influence.

Re: Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a framework for Network Architecture Development of Dominant Carrier Networks, et al. R93-04-003 *et al., Decision Granting Bell Telephone Company's Renewed Motion For An Order That It Has Substantially Satisfied The Requirements of the 14 Point Checklist in Section 271 of the Telecommunications Act of 1996 and Denying That It Has satisfied Section 709.2 of the Public Utilities Code, Decision 02-09-050(September 19, 2002, p. 271-272).*

[7] Selwyn, p. 18.

[8] See Selwyn, p. 19-25.

[9] *Id., p. 21.*

clearest and most direct way to measure such market penetration is to count the access lines that CLECs are actually serving.[10] To that end, Dr. Selwyn relied upon publicly available information reported by the FCC in its Local Telephone Competition Reports. The most recent FCC Local Telephone Competition Report issued in July 2002, indicates that CLECs in Maryland serve only 4.2 percent of the *total* market (well below the 10.2% national average). In a disturbing development, the most recent FCC report indicates that Maryland CLEC penetration has actually decreased from the prior reporting period.[11] As was pointed out by Dr. Selwyn and throughout the hearings in this case, the only other two states in the country which have actually experienced a decline in competitive activity are South Carolina and Mississippi. According to Dr. Selwyn's testimony (garnered from the FCC reports), CLEC market share for residential and small business customers is "at a miniscule 1.6% - down from 2.1% for the period ending June 30, 2001."[12]

Even Verizon witness Roberts agrees that the best measure of CLEC market penetration is to count their actual access lines.[13] Using this best measure, it is clear the level of local competition in Maryland is extremely small and that the level of local competition in the residential and small business market is nearly non-existent. Certainly such a low level of local competition in the State of Maryland should be enough to give the Commission pause in determining whether Verizon's application can meet the public interest test of Section 271.

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[10] *Id., p. 23.*
[11] *Id.,* (This is particularly disheartening because nationally CLEC penetration has increased over the same time period.)
[12] *Id.*, p. 25, ftnt. 31.
[13] T. 1524, 1532.

C. Dr. Selwyn Has Conclusively Shown That Verizon's Reliance On Information From The E911 Data Base Inaccurately Overstates The Level Of Local Competition In Maryland

Both in his Direct Testimony and on the witness stand, Dr. Selwyn provided an extensive critique of Verizon's reliance upon E911 data base as an indicator of the amount of CLEC provided facilities in the Maryland market. The E911 database provides an inaccurate and unreliable picture of the extent of local competition. As Dr. Selwyn explained:

> Verizon's assessment of the count of facilities-based lines based on information obtained from E911 databases is likely in error due to common business communications arrangements such Direct Inward Dialing (DID), where each station line "behind" a PBX is assigned its own unique 7-digit telephone number. A DID customer will obtain a block of numbers from its local carrier, ILEC or CLEC, and that quantity of individual numbers will typically be a multiple of the quantity of physical access lines (PBX trunks) that are being provided to that customer. For example, FCC rules relating to surcharges for Local Number portability (LNP) allow an ILEC to apply nine (9) LNP charges for each PBX trunk or equivalent; thus, in the case of a T-1 trunk containing 24 individual voice channels, the FCC LNP rules contemplate 24 x 9, or 216 PBX stations "behind" the single T-1 facility.[14]
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> More importantly, while Mr. Roberts ultimately contends that the E911 database is a listing of telephone numbers from which outgoing calls can be made, Verizon-Maryland's own E911 data base entries **BEGIN PROPRIETARY XXXXXX**
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[14] P. 28-29.

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[footnote omitted]. **END PROPRIETARY** [15]

As a practical example of how use of the E911 data base overstates the actual number of CLEC access lines in service, Dr. Selwyn explained how a firm that purchases only one T-1 line could, by Verizon's use of the information, result in an overstatement of the actual number of access lines. As Dr. Selwyn testified:

> ….many if not all CLECs have as a practice to populate the E911 data base with all of the DID numbers in a block. So for example, my firm has a block of 100 DID numbers. Therefore, it is my understanding, and we happen to have our local service provided by AT&T, it's my understanding then that we would have 100 entries in the E911 database.
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> Q: But yet you have how many access lines?
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> A: Well we have T-1, which is the equivalent of 24 voice grade lines, although we aren't actually using all of those channels. But in our simply case, that T-1 for example would be capable, if we're using all the channels, to support as many as 3 to 400 station lines, which means that there might be other customers with a T-1 with 24 voice channels that could have as many as 300 or 400 entries.
>
> Q: So instead of counting the 100 as you suggest would the number be 24?
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> A: That would be a more realistic way to count. In this particular instance.[16]

Furthermore, Dr. Selwyn has also pointed out that there is a fundamental flaw in Verizon's analysis related to the fact that Verizon excluded special access lines from its analysis. Dr. Selwyn noted that Verizon appeared to assume that "facilities-based

[15] *Id.,* 29-30.

CLECs consisted of either UNE loops or facilities that were self-provisioned.[17] Verizon apparently would take its own E911 estimate for the CLEC lines and then subtract from that estimate the number of UNE loops that Verizon was providing. Verizon believed that the difference between those two numbers equaled facilities that were provisioned and owned by the CLECs themselves.[18] Dr. Selwyn pointed out that that assumption is incorrect because of the use by CLECs of special access lines. As Dr. Selwyn testified, FCC rules require that when a facility is used for both local and toll service, the CLEC must obtain a special access line rather than a UNE line. Using once again the example of his own firm, Dr. Selwyn testified:

> We have business, local business service provided by AT&T. We have a T-1 facility that AT&T is obtaining from Verizon in Boston. Because we use, we have more than five lines, and are mixing local and toll service on that facility, AT&T is required to obtain a special access line rather than an UNE facility from Verizon.
>
> So here we have a situation where our service would not even come up in Mr. Roberts' count of UNE loops because it isn't UNE loop, and yet there would be 100 entries E911 data base associated with our service. So, therefore, under his reasoning, he would conclude that the CLEC that is providing service to us is actually providing 100 lines to us.[19]

Based upon all those deficiencies, Dr. Selwyn concluded that "I don't think that any weight can be given to the E911 numbers as a matter of fact, separate and apart from the legal matter that I raised earlier."[20]

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[16] T. 1607-08.
[17] T. 1610.
[18] T. 1610-1611.
[19] T. 1612.
[20] T. 1613. (referring to a possible violation of Section 222(b) of the Telecommunications Act).

Finally, to further illustrate the point, Dr. Selwyn provided some calculations to debunk Verizon's attempt to explain away the difference between its calculation of CLEC line penetration in Maryland and the FCC's calculation of CLEC lines. The disparity between the number of CLEC lines identified by Verizon witness Roberts and the 4 percent of CLEC lines identified by the FCC in its report is very easily explained. As Dr. Selwyn testified, Verizon witness Roberts testified that the difference was the result of the fact that there was underreporting in the FCC data because the CLECs with less than 10,000 were not included.[21] Using a simple mathematical calculation, Dr. Selwyn was able to show that at best, the underreporting relied upon by Mr. Roberts to explain the difference between his E911 database results and the FCC report amounts to a little over 43,000 lines.[22] As Dr. Selwyn testified:

> You cannot attribute 300,000 lines as Mr. Robert's was attempting to do, to the small CLECs that weren't reporting to the FCC. You can at best attribute about 43,000 lines."[23]

The point of all these mathematical exercise is of course to show that "if you add up these numbers, [the Commission should] conclude that there is almost no actual facilities- based activity in Maryland where the carrier is providing the loop… .[24] Therefore, as Verizon's reliance on the E911 database as an indicator of local competition has been totally discredited, the Commission must decide whether the paltry level of local exchange competition identified in the FCC report is of a sufficient nature upon which the Commission can rest a decision that granting Verizon's Section 271 approval is in the public interest. People's Counsel believes that the exceedingly low

[21] T. 1615.
[22] See T. 1616 through 1618.
[23] T. 1618.

level of actual competition shown in that report should provide a warning that local competition in Maryland is neither economically viable, sustainable nor irreversible. This does not bode well for competition in general, for so long as Verizon continues to control the lion's share of the local market, it is well positioned, once it receives long distance authority, to remonopolize the long distance market in Maryland, undoubtedly resulting in higher prices to future Maryland long distance consumers. Surely, this result is contrary to the public interest.

D. Verizon's Use Of the E911 Data Base To Bolster Its 271 Application Should Be Rejected As Bad Public Policy

Verizon's use of the E911 database is suspect for an entirely independent reason. Using the E911 database for the purpose of determining the level of competition in Maryland, may violate Section 222(b) of the Telecommunications Act.

As administrator of the E911 data base, Verizon is in a unique position vis-à-vis its competitors. Because Verizon administers the data base and can view its contents through a secure interface, Verizon has the ability to access data about its competitors regarding not only the number of their lines, but the specific geographic location of their lines. It can be argued that Verizon's use of the database to extract such important market information may be evidence of an abuse by Verizon of its monopoly position.

Section 222(b) of the Telecommunications Act provides that "a telecommunications carrier that receives or obtains proprietary information from another carrier for purposes of providing any telecommunication service shall use such information *only for such purpose* and not use such information for its own marketing

[24] T. 1624.

purpose." In this instance, carriers provide Verizon the number of access lines being provided by them as well as the geographic location of each line for purposes of inclusion in the E911 database -- the purpose of which is to provide emergency response agencies with the ability to identify the physical location of an individual who dials 911.[25] For Verizon to use that CLEC E911 information in this proceeding, for the purpose of bolstering its own competitive position, seems to be a prohibited use of the information under Section 222(b) because the provided information is not being used by Verizon for the purpose for which it was provided by the CLECs. As Dr. Selwyn testified, "the very fact that Verizon, for example, in Mr. Roberts' testimony is actually citing E911 results on a carrier-by-carrier basis, is in itself a demonstration that you have a unique situation where Verizon is basically, in my opinion, abusing its role as administrator by obtaining information about its competitors that it is able to use for reasons having nothing whatever to do with E911."[26] Such abuse should not be countenanced. People's Counsel recommends that the Commission reject Verizon's use of the E911 information as a result.

E. The Number Of Completed Collocation Arrangements Is Not An Accurate Indicator of CLEC Competitiveness

While Verizon claims that it has a significant number of existing in-service collocation arrangements as an indicator of the existence of and potential for facilities-based competition, Dr. Selwyn was able to point out that this measurement misrepresents the actual number of CLECs providing telecommunication services in Maryland. First, reliance upon collocation arrangements to show the strength of potential competition is

[25] See *e.g.* T. 1600; Selwyn Direct, p. 26, ftnt. 32.

unreliable as an indicator in the face of a telecommunications market where CLECs are failing in large numbers. As Dr. Selwyn testified, "of the 460 traditional physical collocation arrangements in existence in January 2002, only 283, or 62 percent were still in use in April 2002. Similarly, of the 559 cageless collocation arrangements in existence in January 2002, only 213, or 38 percent, were in use in April."[27] Given the turmoil in the telecommunications industry and the fact that significant carriers are either in bankruptcy or contemplating bankruptcy, it is unreasonable to continue to believe that collocation arrangements will provide a reliable indicator of competitive providers in Maryland.

Additionally, Dr. Selwyn pointed out that many of the collocation arrangements cited to by Verizon are probably being used by data CLECs providing digital subscriber line (DSL) services.[28]

Furthermore, additional opportunities for CLEC expansion or growth have been limited due to mergers among the ILECs.[29] Dr. Selwyn testified that these mergers have "done nothing but create larger, better financed fortress bottleneck monopolies" which cannot help but impede the ability of less well financed new entrants to get a toe hold in the market.[30]

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[26] T. 1603.
[27] Selwyn Direct, p. 32.
[28] *Id.*, p. 33.
[29] See e.g., Selwyn, pps. 36-43.
[30] See Selwyn Direct, p. 40.

F. Verizon Cannot Show That Its Entrance Into The InterLATA Long-Distance Market Will Provide Benefits To Consumers Such That Its Application Could Be Viewed As Being In The Public Interest

Verizon has engaged in a public relations campaign to bolster its Section 271 Application. For example, as part of its press release announcing the filing of its Application, Verizon referenced a study issued by the Telecommunications Research and Action Center (TRAC) which claims that consumers in Maryland will benefit from long-distance entry. Dr. Selwyn showed that this study, as well as other studies that are available in Maryland, "grossly exaggerates the savings consumers might plausibly obtain from RBOCs long-distance entry."[31] Additionally, Dr. Selwyn, discovered, using publicly available information, that TRAC is not the independent "consumer advocate" group it portrays itself as but rather is closely associated with a Washington D.C. public relations firm whose clients include Verizon, Qwest, SBC, Bell South and the United States Telephone Association.[32]

The TRAC study purporting to show benefits to Maryland consumers, is seriously flawed because TRAC compares *specific* Verizon long-distance pricing plans with *averages* of prices being offered by other non-BOC carriers. As Dr. Selwyn testified:

> The correct comparison-and one that TRAC did not perform- would be to compare the best Verizon pricing plan with the best non-Verizon plan applicable to the particular customer's calling volume and other attributes. Instead, what TRAC did was to determine a "range" of savings based upon "low-end" "high-end" estimates of what customers might have been paying to carriers other than Verizon.[33]

[31] Selwyn, p. 46.
[32] *Id.,* p. 47.
[33] *Id.* p. 53.

Instead, Dr. Selwyn demonstrated that "Verizon's pricing plans, when appropriately applied to consumers based upon their actual calling requirements and assuming reasonable rational and informed customer behavior, indicate that Verizon's entry into the long-distance market provides consumers with *no competitive gain whatsoever*."[34]

Furthermore, the Progress and Freedom Foundation (PFF) paper referenced by Dr. Selwyn does not support the view that consumers stand to benefit by Verizon's entrance into the long-distance market. First, as with TRAC, the Progress and Freedom Foundation is a beneficiary of financial support from Verizon as well as from SBC and Bell South. Dr. Selwyn criticizes the PFF paper as naïve and superficial for its reliance on industry trends identified by Trade Association press releases and CLEC marketing materials. In Dr. Selwyn's view, the Commission should place no reliance on PFF's predictions as a basis for decision in this proceeding. Dr. Selwyn recommends that the Commission base its decision on what is known or knowable at present. As Dr. Selwyn put it, "if the growth trends for CLECs were very stable and secure, it might be reasonable to make limited projections into the future. However, as the events of recent months highlight, it is very hard to know how various competitors or industry segments will perform prospectively. Since well before the 1996 Act, RBOC economists and other spokespersons have been overstating the pace of growth in local competition."[35] Therefore, as with the TRAC study, the Progress and Freedom Foundation study is of

[34] *Id. p. 55,* Dr. Selwyn provided many examples in his testimony to demonstrate the flaws in the TRAC study. People's Counsel urges the Commission to review Dr. Selwyn's testimony at pps. 52 through 58 for those particular examples.
[35] *Id.,* p. 62.

little reliable use to the Commission in making a determination of whether consumers will benefit by Verizon's entrance into the long-distance market.

G. The Potential For Remonopolization Of The Long Distance Market If Verizon Receives Section 271 Authority Is Further Evidence That Verizon's Application Should Be Rejected

It does not take a great leap in logic to conclude that the larger Verizon's share of the local market, the greater would be its opportunity to preemptively market its affiliate's long distance service to its local service customers. This is particularly true when customers have no choice but to contact Verizon for local service and Verizon retains the right to market long distance service to its customers. This in effect blocks other long distance providers from marketing and obtaining those customers.[36]

Dr. Selwyn conducted a study to actually quantify the impact of Verizon's joint marketing advantage. The methodology of Dr. Selwyn's study is described in his testimony at pps. 66-76. The results of the analysis are interesting. For example, Dr. Selwyn's "Scenario 1" demonstrates that "if the current Verizon *local service* market share of 96.7% is maintained throughout the five-year period covered by the model, at the end of that time Verizon Long Distance will have captured some 71.1% of all Maryland residential subscribers in Verizon service territory."[37] Under his Scenario 3 (in which CLECs are relatively successful in capturing local customers) at the end of the 5th year,

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[36] *See e.g.,* Dr. Selwyn direct, p. 64-76.

[37] *Id.*, p. 68.

"Verizon's local market share would then be 66.7%, but its long distance market share would be comparable to that of the largest IXC today, at 59.5%."[38]

In response to questions from Commissioner McDonald, Dr. Selwyn pointed to results from Connecticut to show that when there are large segments of a state in which customers do not have competitive choice and the incumbent enjoyed a joint marketing opportunity, then customers find themselves "in the situation where they will face pre-empted marketing effort by the incumbent… ." [39] Dr. Selwyn went on to testify that:

> …reported figures that are coming now from the, from both Verizon and SBC, indicate enormous success in achieving market share, particularly in the residential segment, based upon that joint marketing, and the opportunity to exploit the inbound channel.
>
> SBC, for example, just within the past several weeks reported that their market share in Connecticut, which has had long-distance entry for the longest time because Connecticut was not, is not a state that required a 271 approval for SBC… . has now indicated that they have 62% share of the long-distance market. And suggested that that was probably the sort of target level that they were expecting nationwide once their service was rolled out over time. In my view, the fact that they've been able to amass that kind of market share is precisely due to the combination of their extremely high share of the local market which exists particularly in the residential sector everywhere in the country, and in the fact that they have the ability to jointly market long-distance before the customer has an opportunity to shop around for an alternate provider.[40]

Such remonopolization clearly cannot be viewed as in the public interest. As Dr. Selwyn noted,

> As long as Verizon is permitted to exploit its captive relationship with the vast majority of local service

[38] *Id., p. 6*9.
[39] T. 1627.
[40] T. 1627-1629.

> customers to market and sell its affiliate's long-distance services, Verizon long distance shares will grow rapidly and nonBOC IXCs will suffer a precipitous decline in customers and demand. Faced with such losses, IXC costs will rise and at least some IXCs will be forced to exit the business. Further exacerbating the situation and affording the BOCs an even greater opportunity to remonopolize the nation's long-distance market. [41]

In order to combat this situation, People's Counsel recommends that if the Commission does recommend approval of Verizon's Section 271 Application, the Commission should include restrictions on Verizon's use of the inbound channel to market its long distance service. A fuller discussion of recommended restrictions will be found in Section H *Supra.*

H. Verizon Has Failed To Comply With The <u>Section 272 Separate Affiliate Requirements</u>

People's Counsel acknowledges that this Commission is under no specific obligation to review Verizon's compliance with the requirements of Section 272. However, People's Counsel believes that as part of its public interest analysis, and consistent with State Law, the Commission should review Verizon's compliance with that Section.[42]

The purpose of the Section 272 Separate Affiliate Requirement and code of conduct is to forestall the potential for discriminatory and anticompetitive conduct that could arise out of Verizon's ability to extend its market power in the local

[41] Selwyn, p. 73-74.

[42] Legislation that became effective on October 1 of this year bolsters the Commission's authority to adopt and implement policies governing the development of competition in the Maryland telecommunications market. House Bill 1164 modified Section 8-501 of the PUC Article to allow the Commission to "adopt policies and regulations governing the development of competition." These policies should include adopting measures to prevent affiliate abuse by Verizon.

telecommunications market into the adjacent long-distance market. To ensure that Verizon, once it receives Section 271 authority in the state, maintains the appropriate competitive safeguards, the Act sets out various structural and procedural requirements in Section 272. For example, Section 272 requires that Verizon establish a separate affiliate to provide interLATA service, limits how Verizon and its affiliates can conduct joint marketing, sets requirements for use of employees among affiliates and requires a joint state/federal biennial audit. The Act specifically requires that, when reviewing that audit, the *State* consider "particularly whether such company has complied with the separate accounting requirements under subsection (b)."[43]

The FCC anticipated a broad role for state commissions in that audit process. The FCC noted that "the Commission and the State need to oversee the scope, terms and conditions of the biennial audit. Without such oversight, it would be uncertain whether the audits would achieve their primary objective of ensuring that the carriers, have, in fact, complied with Section 272 of the Act… ."[44] Because the Maryland Public Service Commission will be involved in that audit process if Verizon obtains Section 271 authority, People's Counsel recommends that the Commission consider at this time whether Verizon has provided sufficient plans for compliance with the requirements of Section 272. An examination of the requirement of Section 272 either at this time or in the very near future, will prevent Verizon from being allowed a "free ride" during the critical first years of its interLATA operation. Unless requirements compliant with Section 272 are examined and put in place shortly, Verizon will have an opportunity in the time before the audit to engage in cross-subsidization and discriminatory activities.

[43] See 47 U.S.C. 272(d)(1).

As Dr. Selwyn testified in response to questions from Chairman Riley, the Commission has a number of options regarding how it would ensure that Verizon complies with Section 272(b) requirements. For example, the Commission could adopt and enforce cost allocation rules.[45] Additionally, the Commission could adopt various imputation rules and consider them as part of any ratesetting requirement.[46] As Dr. Selwyn testified:

> You could consider it [cost allocation or imputation] in review of the Price Cap Plan for Maryland and other things of that sort, separate and apart from the existence of a separate affiliate or what the FCC ultimately does with respect to any audits or sunsets or whatever.
>
> So I think the Commission not only has that authority, I think the Commission has an obligation to address those issues, and to focus on that. I think one of the things you can do in this case is to consider, when you issue your order and consultative report is to identify specific things that you think Verizon should be required to do as part of the conditions for approval, and if nothing else, simply identify to Verizon if they go into the long distance business you are going to require them to do these things in Maryland.[47]

In fact, the FCC has found that State Commissions may impose any requirements on BOCs seeking Section 271 authority they deem necessary short of denial of entry into the interLATA market.[48]

The importance of putting in place and enforcing safeguards can be determined by an examination of what has already happened in the market. As Dr. Selwyn noted, "empirical evidence from states with Section 271 Approval indicates that, as currently

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[44] *See Re Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996,* CC Docket No. 96-150, Report and Order, para. 197 (1996).
[45] See *e.g.* T. 1639.
[46] *See e.g.* 1639-40.
[47] T. 1640.

applied, Section 272 fails to prevent discrimination and anti-competitive conduct by the BOC on behalf of its long-distance affiliate."[49]

It is instructive to review what has occurred in other Verizon states. For example, Dr. Selwyn noted that, based upon Verizon's various Section 272(b)(5) Affiliate transaction postings on the Company's website and its first Section 272 audit report in New York, it has become apparent that the interactions between Verizon and its long-distance affiliates raise serious questions as to the actual extent of "separation" that actually exists between these two supposedly separate corporate entities. The New York audit points to a significant portion of interactions related to "joint marketing," joint account administration, and combined billing of Verizon's local and long-distance services. As Dr. Selwyn testified "each of these activities is undertaken by the BOC (Verizon) and its affiliate as if, for all practical purposes, Section 272 did not exist." [50]

1. Evidence From New York Indicates That Verizon May Fail To Comply With The Specific Requirements Of Section 272(b) Regarding Joint Marketing Of Local And Long Distance Services

While the Telecommunications Act does not prohibit Verizon jointly marketing its long-distance service with local service, the Act does make such joint marketing subject to all of the separate affiliate provisions set forth in Section 272(b). Therefore, any joint marketing must be performed on an "arm's length" basis, and the long-distance affiliate must pay Verizon the fair market value for all joint marketing services. Dr. Selwyn's analysis shows that Verizon Long-Distance has not been paying the Verizon

[48] See 11 FCC Rcd 21929 (Non-Accounting Safeguards Orders).
[49] Selwyn Direct, p. 85-86.
[50] Selwyn, p. 89.

BOC the fair market value for joint marketing services in other states. One example is Verizon Long-Distance payments to Verizon-New York for customer acquisition/joint marketing services. Verizon Long-Distance pays only $7.71 per contact. As Dr. Selwyn testified: the magnitude of such payments is woefully short of the fair market value of these services and of the customer information that is being beneficially furnished by the BOCs to their affiliates."[51] Under questioning by the Commissioners, Dr. Selwyn noted that the actual fair market value of those customer acquisitions and joint marketing services are " in the hundreds of dollars on a per customer basis when you include these promotions and advertising and direct mail and divide that by the number of successes that they [the long-distance companies] achieve. And yet Verizon prices this supposedly arms length price, fair market value price at $7."[52] Clearly, such unequal treatment has the potential to adversely affect the development of competition in Maryland.

The marketing advantage enjoyed by Verizon from use of its "inbound channel" to sell their affiliate's long distance service to its local service customers allows Verizon the ability to crush its competitors. Dr. Selwyn quoted a Credit Suisse First Boston (CSFB) report which noted this dominance:

> We've been watching the industry for almost 20 years and we have never seen consumer share gained at the rate of Verizon in New York and SBC in Texas (the former 20% share in 12 months and the latter 18% share in 6 months).[53]

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[51] Selwyn, p. 92.
[52] T. 1637; see also Selwyn Direct, p. 94-96 (Dr. Selwyn noted that the extensive advertising, telemarketing, direct mail and special promotion pursued by long-distance companies as marketing strategies amounts of hundreds of dollars per customer acquired. In fact, Dr. Selwyn noted at least one analysis that put the cost at between $300 and $600 in sales support, marketing and commissions per customer acquired).
[53] Selwyn, p. 97 (quoting CSFB February 8, 2001 Report).

2. Verizon's Long-Distance Affiliate Could Receive An Unfair Advantage Due To The Pricing Of Billing And Collection Services

Verizon's provision of joint local and long-distance billing as well as tie-in discounts for purchases of combinations of local and long-distance services provides another example of how its affiliate benefits vis-à-vis its competitors. The Verizon BOC is going to print and mail a local service bill and process the payments it receives. However, it can include the Verizon Long-Distance charges on its own billing statements at little or no cost because such inclusion would not require additional envelopes and rarely would require additional postage. Additionally, the cost of processing the payment is not affected by the inclusion of long-distance charges. If this transaction were truly at "arms length" Verizon Long-Distance would be recording the cost of this billing and collection on its own books. However, as Dr. Selwyn testified, it appears that Verizon Long-Distance actually was recording the lower costs of the consolidated billing on its books. On the other hand, long-distance providers that are not affiliated with Verizon, incur real out-of-pocket costs for billing and collection functions.[54]

3. The Commission Should be Concerned That Verizon's Long Distance Affiliate Will Have The Ability To Shift The Costs Of Recruiting And Hiring Qualified Employees By Merely Recruiting Verizon's Local Service Employees

Section 272(b)(5) requires that all goods and services offered by the local company to the Section 272 Affiliate must be reduced to writing, compensated according to the FCC's Affiliate Transaction roles, and made available to all competitors on the same terms and conditions. However, there is a distinct possibility that employees may be transferred from Verizon operating companies to Verizon Long-Distance affiliates and that none of those requirements will be followed. As Dr. Selwyn testified, "by an outright transfer of employees from the Verizon BOC to Verizon Long-Distance, Verizon Long-Distance also has access to a highly trained and experienced workforce it obtains without recruitment or training costs."[55] This Commission could avoid such a result by following the lead of the California Public Utility Commission which required that for any Bell Operating Company employee transferred to an affiliate, the affiliate gains intangible value from the BOC and the BOC is therefore entitled to compensation for that value.[56] The California PUC adopted a 25% "employee transfer fee" to be applied against the annual salary of any Pacific Bell Employee that transferred to an affiliate. Such on approach should be considered in Maryland.

4. Summary of Recommendations Regarding The Consumer And Competitive Safeguards of <u>Section 272</u>

In order to avoid some of the abuses identified above, People's Counsel recommends that the Commission should, at a minimum, consider directing Verizon-Maryland to implement the following Section 272 practices.

- The Commission should prohibit improper self-dealing by requiring that Verizon Maryland file with the Commission and make available for public inspection all fair market value studies undertaken, including a study estimating the fair market value of joint marketing and customer acquisition services, and the complete process and data used to determine

[54] See Selwyn, p. 102.
[55] Selwyn, p. 107.

the fully distributed cost for services priced under either of these two methods. If Verizon fails to make such a filing, it should not be permitted to provide the service in question. In addition, the Commission should direct the auditor, during the joint federal-state biennial Section 272 audit proceeding, to examine all of these filings, not just a random sample.

- The Commission should apply non-solicitation rules to the transferring or movement of employees from Verizon Maryland to Verizon Long Distance. While employed at Verizon, no employee of any Verizon entity should request or solicit an employee of Verizon Maryland, or cause another employee of Verizon Maryland to be solicited, to transfer or move employment from Verizon Maryland to Verizon Long Distance. Verizon should not post in Verizon Maryland Offices or on Verizon electronic medium, or allow Verizon Long Distance to post in Verizon offices or on Verizon intranets or other electronic media, advertisements for or notices of availability of Verizon Long Distance positions.
- The Commission should find that, as long as Verizon Maryland has market power in the local market, it is able to artificially inflate the "Prevailing Market Price" of billing and collection services offered to competing IXCs. The Commission should require that Verizon Maryland price billing and collection services provided to Verizon Long Distance at the lesser of fully distributed cost or fair market value, and made available to competitors at the same price.

[56] See Selwyn, p. 107.

- The Commission should strengthen the affiliate transaction rules by directing the affiliates to operate such that the management of each entity (Verizon Maryland and Verizon Long Distance) each make all affiliate transaction, service offering, and pricing decision only with respect to the bottom line of each respective entity. For example, Verizon Long Distance should not be permitted to ignore the per-account billing fees it pays to Verizon Maryland when offering service plans that do not include fixed or minimum monthly charges. Such plans, if offered by Verizon, would effectively negate the "arm's length" relationship by substituting the actual out-of-pocket costs to the parent Verizon Corporation for the incremental long distance billing (which are minimal) for the "payments" that Verizon Long Distance is nominally required to make to Verizon Maryland for the billing services. Where the apparent corporation balance sheet is the only consideration, Verizon Maryland and Verizon Long Distance will continue to cost-shift wherever possible so as to establish false competitive prices or prevent Verizon Maryland from earning income from affiliate transactions that could ultimately be used as a basis for Verizon Maryland to seek rate increases for its regulated monopoly services either by revising its price cap structure or by some other "extraordinary" form of "relief."

I. Since Local Competition For Residential Services Has Failed To Materialize In Maryland, The Commission Should Approve Verizon's Application Only For Business Services

It is clear from the evidence provided in this proceeding that the state of local competition in Maryland in general is less than desirable. However, the state of local competition for residential services can only be characterized as dismal. As noted previously, CLEC market share for residential and small business customers is "at a miniscule 1.6% down from 2.1% for the period ending June 30, 2001."[57] There may be any number of reasons why, despite legislative and regulatory efforts at both the federal and state levels to encourage the development of effective competition in the local residential market, Verizon Maryland still maintains overwhelming dominance in that market. As Dr. Selwyn testified, even this extremely limited amount of local residential competition may be in serious jeopardy due to the downturn in CLECs' stock performance, the ever increasing number of CLEC bankruptcies and a failing economy. This is serious cause for concern as noted throughout this brief.

Since competition for local residential service in Maryland ranks near the bottom of all states, People's Counsel proposes that this serious problem deserves a radical solution. Therefore, People's Counsel urges the Commission to seriously consider recommending to the Federal Communications Commission that Verizon receive Section 271 authority for business services only.

On its face, Section 271 does not appear to prohibit such an approach. In fact, Section 271 provides that "a Bell operating company, or any affiliate of that Bell operating company, may provide interLATA services originating in any of its in-region

[57] Selwyn, p. 25.

states (as defined in subsection (i)) if the Commission approves the application of such company for such state under subsection (d)(3)." By its terms, the statute references only the "operating company;" however, the statute makes no distinction between or among services provided by that company. Because the statute on its face does not distinguish among services, this leave open the possibility that the Commission could recommend Section 271 authority for Verizon Maryland but limit that authority to the provision of long-distance for business customers only. Such a restriction would allow extra time for local competition to attempt to take hold in the residential market. Section 271 does not affirmatively appear to prohibit such a separate service analysis; therefore, People's Counsel recommends that the Commission consider this approach.[58]

III. **CONCLUSION**

Given the acknowledged dismal level of local competition in Maryland (especially among residential customers) along with the marketing advantages that Verizon will have in selling its long-distance services to captive residential and small business subscribers, the Commission should conclude that granting Verizon Maryland authority to enter the Maryland long-distance market is not in the public interest. However, should the Commission decide that there is a sufficient level of competition for business services, People's Counsel recommends that the Commission grant Verizon its Section 271 authority for those business services only and withhold such an authority for

[58] For example, in *Competitive Telecommunication Association v. Federal Communications Commission et. al.,* recently decided by the United States Court of Appeals for the District of Columbia Circuit, the Court noted that "in *United States Telecom Association v. Federal Communications Commission* (citations omitted), we clearly found in the FCC an authority to make distinctions that were based on regional differences or on customer markets….if these are permissible, it is hard to understand why the Act would not allow restrictions keyed to a specific "service" of the requesting carriers." *Competitive*

the residential market. Allowing Verizon Maryland full access to the long-distance market in Maryland will lead to the inevitable remonopolization of the Maryland long-distance market. That failure of competition will ultimately lead to higher prices and fewer choices for Maryland consumers.

Furthermore, should the Commission recommend full Section 271 approval, the Commission should recognize the ability of Verizon to operate its local and long-distance operations in an effectively integrated way. Although Section 272 of the Telecommunications Act requires structural separation of Verizon and its Section 272 long-distance affiliate for the first three years following its Section 271 approval, the Commission should keep in mind that in those regions where Verizon has been granted interLATA authority, the Company "consistently operates in a manner that simulates full integration while purporting to "comply," albeit facially, with the separate affiliate requirement. Through cross subsidies and predatory pricing in the form of joint marketing, billing, and product tie-ins, Verizon Long-Distance is able to leverage the Verizon Maryland 96.7% *local* market share into pricing plans that cannot be possibly matched by its IXC competitors, even by competitors offering a bundle of local and long-distance service."[59] Therefore, the Maryland Commission must ensure that Verizon Maryland agrees to comply in a meaningful way with the Section 272 Code of Conduct. The Commission should also consider directing Verizon Maryland to implement the consumer and competitive safeguards listed in Section H.4 of this brief. Adoption of those safeguards will help to prevent exploitation of Verizon's affiliate relationships to the detriment of its competitors and customers alike.

Telecommunications Association, No. 00-1272, 2002 U.S. App. LEXIS 22407 at 22410 (decided October 25, 2002).

Continued for signatures:

Respectfully submitted,

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[59] Selwyn Direct, p. 119.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY on this ____ day of November, 2002, that a copy of the Brief of the Maryland Office of People's Counsel has been either hand-delivered or sent by overnight delivery to all parties of record.

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